Compliance in the Financial Sector

Fatima Eljaouhari

Southern New Hampshire University

Professor: Mitchell, Daniel

*Compliance in the Banking Sector*

*Introduction*

Attaining regulatory compliance is an essential concern for contemporary financial institutions across the globe. In the aftermath of the 2008 financial crisis, not only are regulations being tightened, but regulatory fees are also increasing to unprecedented levels. On the one hand, the occurrence of regulatory pressures as a result of stiff financial regulations is considered a vital issue pushing banks to reconsider their strategic goals in their quest to ensure compliance at the expense of value creation. On the other hand, there is a strong argument in the favor of financial regulation, as it has promoted a safer, stable, transparent and highly robust banking system that is less prone to a financial meltdown (Jordana & Rosas, 2014).

My approach to the issue of regulatory compliance is in favor of increased financial regulation aimed at promoting compliance, managing risk and supporting banking stability. My interest in this topic is motivated by the available information on how the lack of reliable financial regulation contributed to the 2008 global financial crisis. The financial crisis of 2008 was caused primarily by an unregulated market of trillions of dollars of derivatives. The speculation of higher rates spiked risky investments as private firms such as Long-Term Capital Management (LTCM) managed to get huge returns for investors. This encouraged other investors to pour in more money which saturated the market with over-the-counter derivative as weak regulation made it unnecessary to trade derivatives through a clearinghouse. If there was more regulation, there would have been proper compliance and risks taken would have been minimized. This phenomenon would have ensured the prevention of a global financial catastrophe.

*Discussion and Analysis*

A major issue is the amount of change that has taken place in consumer expectations. According to Hagendorff, Vallascas, and Keasey (2013), the rise of new information and communication technologies (ICTs) is credited for positively transforming how modern people interact with the banking institutions. Before the advent of the internet, people used to rely on just one bank for all of their financing needs ranging from mortgages to student loans to business loans. This produced a steady flow of customers and gave repeat business to banks who focused more on the product that they were providing, rather than the customers they were serving. However, the age of the internet has brought about a revolution in the banking sector as more and more companies have started to offer the financial services that were considered to be the exclusive domain of banks. An example of this phenomenon is SoFi, an online lender for refinancing student loans for high achieving graduates of top American universities. The incredible service SoFi provided to its customers, garnered it a huge clientele swiftly and its popularity skyrocketed. Although it started with only refinancing student loans, SoFi expanded to include mortgages and personal loans. This success resulted in banks losing a lot of business that would otherwise have come to them regardless of the quality of services they were providing. The story of SoFi demonstrates that customers will have additional options to choose from in the market because financial services are not the exclusive domain of the banking sector alone.

This increased competition has led to customers having an array of choices which has inevitably made it difficult for banks to compete with other companies for a larger share in the financial services pie. This has given rise to customer-centric approach in the banking industry because banks have realized that this approach is necessary if they are to retain their clientele and attract new customers as well. In order to achieve a customer-centric business model, services have been personalized to account for the evolving customer expectation. The personalization of services has led to an increase in cost of doing business for banks, making personalization difficult to achieve while maintaining competitive prices. Moreover, the shifting demands of current customers might be responsible, at least in part, for the stiff competition and high cost of banking services and associated products.

Information and Communication Technologies have made it possible for the banking services to focus on providing consistent, customized and responsive customer service experiences to support value creation. The main point of interest is that the customer-centric approach is gaining momentum in today’s digital age. Banks that prioritize customer experience and satisfaction derive a development agenda that has a much greater chance of yielding success. Customer-centric approach is simply more efficient at driving growth for a bank than the old-school product-driven approach. Expecting a more personalized experience, customers are increasingly drawn towards companies that care about customer’s priorities and events in life. Banks should account for the changes in a customer’s life and offer the relevant services to gain customer’s trust and loyalty.

After the 2008 financial crisis hit the world, regulation has been tightened in order to prevent another financial disaster. One of the most important regulation is the acquisition of data about the industry. The lack of knowledge about the size of the derivatives market was the main reason the 2008 crisis could not be contained as no one knew how much money had been lost to over-the-counter derivatives. So, information about market size is essential for any regulation and the same has been implemented in the banking sector. Another aim of regulation is to keep the sector competitive enough so that it provides maximum amount of benefit for the proprietors, employees as well as the customers. This ensures fair business practices and a chance for new entrants to set a foot in the market, attracting investment. The laws further help in making the markets efficient to operate in because the involved parties must remain under specifically designed rules. The rules are designed to maximize competition and ensure smooth business environment. There are limited duplications and other inefficient methods of operation in the market as well but most banks choose to opt to follow the designated rules. In an attempt to comply with the rules and regulations of the banking sectors without taking irreparable damage, some trade-offs may be opted for. A tradeoff could be the high cost of adhering to the rules since this will increase the cost of doing business, increasing the prices of end product as well.

The high costs are usually associated with the expenses of compliance. This is because the financial institutions have to incur high costs to benefit from the rules. Some regulatory bodies usually charge a cost on each new regulation adopted in addition to the maintenance costs. The institution has to own a compliance department to align the rules and regulations to the daily activities of the aforementioned institutions. The cost of hiring employees, technical professionals and setting up new departments with all necessary equipment is costly. It increases the outlays of operation and may drive the institution to perform poorly, negating any positive aspect of the adherence to rules.

The contributions of the regulations imposed on the financial institutions is vast and as such the compliance of the banking sector should be encouraged. This is because this sector is prone to the market dynamics in every industry so its compliance to the rules and regulations is crucial if another disaster like the 2008 financial crisis is to be avoided. For instance, a shortage of oil and gas does not directly disturb the bank or its business but it will indirectly affect it because market will have slowed down and inflation would have been higher. However, the process of adherence to the regulations is not cheap and there are significant costs that are going to be incurred during the process. The bank’s protection from defaulting on its payment, safety from low amount of liquidity and the maintenance of healthy competition can only be achieved when compliance is in place. Therefore, any institution intending to operate efficiently in the market should have a compliance department. The department gives knowledge of the new regulations and helps in implementing them within the institutions. The role of such a department is crucial because it ensures that the said business stays out of any potential legal trouble. This also brings about better business practices since most regulations have been designed to further bank’s achievements and ensure their survival in the long run.

My target audience is all the people involved in the banking sector including the managers, employees, the regulating bodies, government, and all the third parties in the industry. For the regulating agency, I will take it as a challenge upon myself to negotiate a better priced regulatory framework that suits all the parties involved in the business. My focus will solely be on getting a reduced price so banks comply out of their own will and not because of fearing legal trouble. Once banks start to adopt regulations, they can then focus on customer-driven approach to banking and as we have discussed above, that yields excellent results for the business. Another benefit of reducing regulation fee is that small banks will be able to ensure compliance along with big banks.

Moreover, managers and shareholders need to realize the immense benefits of customer-centric approach. They need to see it as an opportunity, rather than a burden that minimizes profits. This approach helped the young company, ServiceNow, gain a market valuation of 30 billion dollars in just 15 years of operation. The company rightly identified that the customer should be the first priority, because this customer satisfaction will lead directly to enhanced revenues and profits. The banking sector needs to adopt the same approach. Furthermore, banks have to realize the benefits of adopting proper rules and regulations because the compliance of these regulations is one of the most important factors in success. A survey conducted in late 2018, customer experience decision makers polled that they prioritize customer satisfaction even above terms like ‘revenue maximization’ and ‘net growth’. This demonstrates the importance of customer satisfaction and following regulations, especially in the highly volatile banking sector. Failure to meet the regulations will inevitably result in a loss of business along with the threat of being driven out of business altogether, as so many banks did in the 2008 financial crisis.

*Conclusion*

For any bank intending to thrive in the competitive market, it should adopt compliance at any cost. However, it must also consider carrying out the cost-benefit analysis to avoid operating in losses. The agreement is inevitable that if the banks are preventing fraudulent activity in operations, the benefits will be immense. The compliance may look costly, but the impacts of not complying are far-reaching and much more expensive. Banks need to direct attention towards viable and essential regulations so as to avoid legal troubles and stay afloat in times of economic downturns. Moreover, customer-centric approach is the key to gaining market share for new entrants and the main tool through which big banks retain their clientele. In the digitally driven world of today, ICT plays an essential role in business and customers expect a personalized experience that is geared towards their specific needs.

References

Magrath, M. (2018).Top Banking Regulations Security Compliance Requirements for 2018.Retrieved From: <https://www.corporatecomplianceinsights.com/best-of-2018-top-banking-regulations-security-compliance-requirements/>

Tarullo, K. D. (2008). BANKING ON BASEL: THE FUTURE OF INTERNATIONAL FINANCIAL REGULATION 139-90. Peterson Institute for International Economics. 2014 Vol. 47, p1, 1p.

Hagendorff, J., Vallascas, F., & Keasey, K. (2013). Size, Risk, and Governance in European Banking (Vol. 1st ed). Oxford: OUP Oxford. Jordana, J., & Rosas, G. (2014). When do autonomous banking regulators promote stability? European Journal of Political Research, 53(4), 672–691.